

Second Quarter 2017

Quote of the Quarter:

“You can’t be driven by money. Money is a perversion of the process. You have to be driven by an ideal. Then, money is a consequence.”

-Ian Schrager,
speaking of his many
entrepreneurial
endeavors

Summertime

We are at the midpoint of 2017, and summer is in full swing. The first half of the year has been nothing short of terrific here at North Sky. We have been actively harvesting from our mature funds, including the two largest distributions in our 18-year history (Alliance Funds I and II). Several prominent portfolio companies have gone public or been acquired (for example Yext, Snap, Click Energy and Heptagon). We have been actively investing across both our series of impact funds and our series of traditional private equity funds in areas that we believe are compelling and where the competitive dynamics are favorable. We also have hired additional personnel and positioned the firm for future growth. In addition to hiring Kyle Kroeger for our impact funds in Q1, we hired John Feistner in Q2 for our PEP funds—see Firm and Fund News below for more on John.

The focus of this quarter’s commentary is reporting on market conditions, including data from key areas of private equity and impact investing. We also have several important observations we wish to share with you regarding secondaries, co-investments, troubling fee trends at some buyout funds and the growing disparity of returns between the top and bottom quartile funds. We will share those observations in our upcoming Q3 commentary.

Returns Expectations

Private equity investors ought to be paid a premium return for bearing the illiquidity associated with private equity. Therefore, we regularly check the returns expectations of the industry’s top consultants. Below is a representative list.

Expected Return for 2017 ¹	
Global Bonds	1.00%
Treasuries	1.75%
Core bonds ²	2.65%
TIPS	3.00%
Commodities	4.75%
High-Yield Bonds	4.75%
Large Cap Equities	5.75%
Hedge Funds	5.95%
Real Estate	6.00%
Real Assets/ Infrastructure	6.00%
International Developed Equities	7.25%
Private Debt	7.25%
Private Equity	8.25%

Three observations:

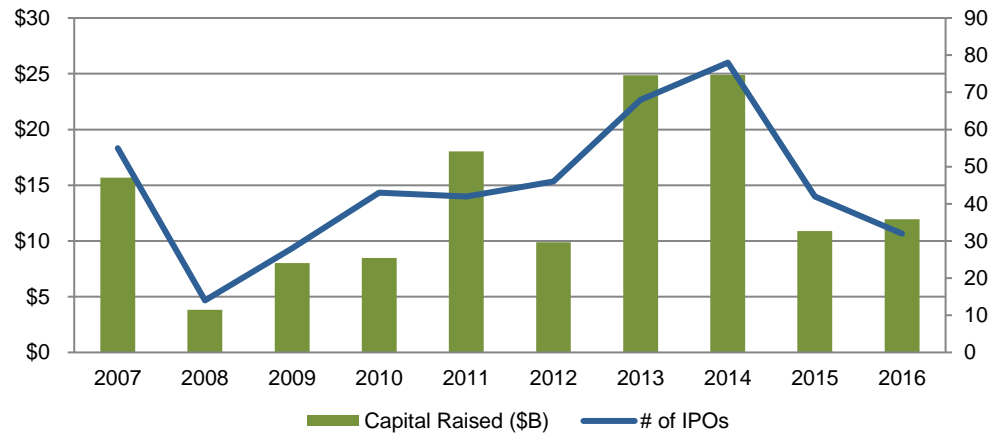
- Returns expectations for 2017 are muted across all asset classes
- The 8.25% return expectation for private equity is the highest return in the table
- Per the above table, private equity returns are expected to beat public equity returns by 100-250 bps. We are happy to report that our mature PEP funds (PEP II-IV) have been beating the S&P 500 by 250-300 bps and the MSCI by 490-720 bps!

Private Equity Market Data

The following charts show market activity for the entire U.S. private equity industry:

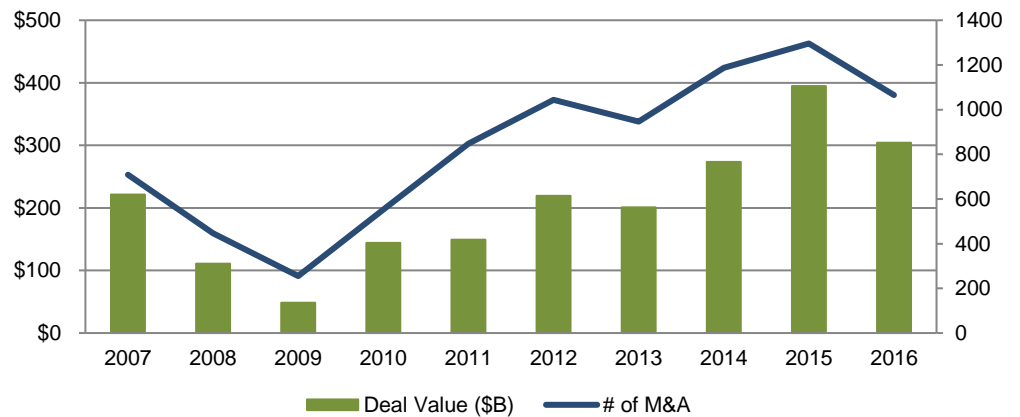
U.S. PE-backed IPOs³

- Activity has normalized following a surge relating to pent-up backlog due to the recession



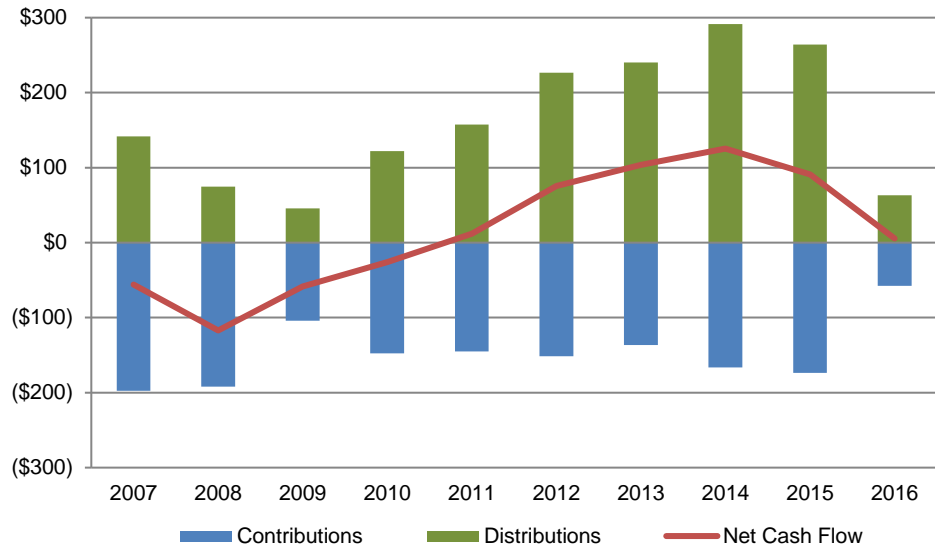
U.S. PE-backed M&A³

- Elevated M&A deal activity continues as corporations continue to buy growth
- Activity tapered off in 2016 in part due to uncertainty caused by the election



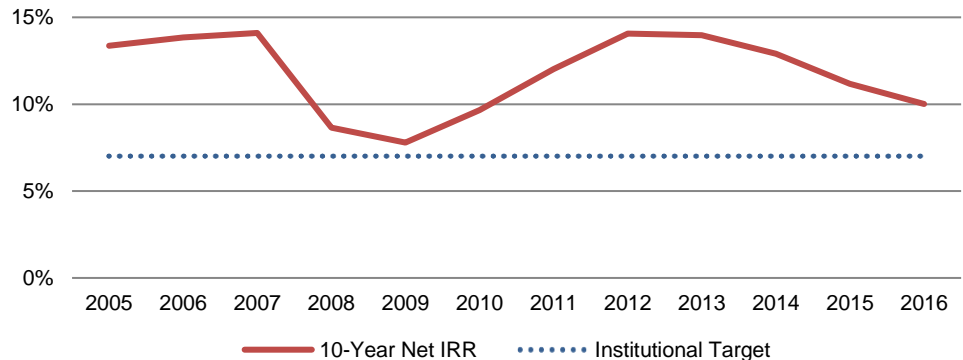
U.S. PE Funds Annualized Cash Flow by Year

- Distributions from funds to LPs > contributions for the 6th year in a row



U.S. PE Returns have Fully Rebounded Post-Recession⁵

- PE returns continue to exceed the levels pension funds need to meet their obligations
- Returns across most major asset classes, including PE, have declined in recent years



Growth of Impact Investing Continues

More investors are using sustainable, responsible and other related factors in their investment portfolios. Investors are committing to private funds that make the world a better place such as those that build renewable energy power systems or that invest in innovation in areas like energy, food, water, transportation and manufacturing. Investors are also allocating capital to mutual funds, ETFs and active managers that use ESG screens and/or utilize shareholder resolutions and other forms of engagement with company management to change business practices.

About one-fifth of all investment dollars under professional management consider ESG issues in selecting investments or utilize shareholder resolutions regarding ESG issues at publicly-traded companies.⁶ Specifically, at the start of 2016 assets engaged in sustainable, responsible and impact investing practices represented \$8.7 trillion of the \$40.3 trillion in total assets under management.

Sustainable, Responsible and Impact Investing in the United States 1995-2016⁷



Firm and Fund News

Team Additions

We are pleased to announce the addition of John Feistner in Seattle, WA. John now leads the business development efforts for our Private Equity Partners series of funds. His over 20 years of investment and advisory experience at US Bank Private Client Reserve and UBS and his extensive network of HNW and institutional investors have been a terrific addition to the team. Sarah Nelson has joined the administration team in our Minneapolis office. She previously was at Prairie Family Business Association and is a recent graduate of the University of South Dakota. Also, we have added two interns: Parker Montgomery and Jorgen Salvesson. Parker is an economics major at Boston College and Jorgen is an economics major at St. Olaf College. Both are working on a series of projects that span private equity, infrastructure and impact investing.

Recent Impact Funds

We have invested \$107mm of Alliance Fund II (\$240mm) so far and have already had two nice liquidity events (one big and one small). We have an excellent pipeline of additional opportunities that span wind, solar, energy storage and biofuels. We have two potential deals under Letter of Intent. Our goals are to generate great investment returns while also creating high-quality jobs and measurable environmental benefits. Similarly, Clean Growth IV is off to a great start. We are closing on three small secondary investments right now. Upon completion, we will have made seven investments. The fund held a final closing on May 2 but is already out of the J-curve.

Upcoming Events

Also, we are regular speakers and attendees at key industry conferences. We hope to see you at these upcoming conferences:

- June 26 **PartnerConnect Midwest**, Chicago, IL
www.partnerconnectevents.com
- June 13 **Sustainable Investing Solutions**, Minneapolis, MN
- July 18 **Investing for Impact**, Boston, MA
www.investingforimpacetevents.com
- July 19 & 20 **Impact Capitalism Summit**, Nantucket, MA
www.impactcapitalismne.com
- Sept. 10 **Solar Power International**, Las Vegas, NV
www.solarpowerinternational.com

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¹ Source: New England Pension Consultants.

² Core Bonds is a blend of Treasuries, investment grade corporate bonds and mortgage backed securities.

³ Source: Pitchbook.

⁴ Source: Pitchbook. 2016 data through 3/31.

⁵ Source: Cambridge and North Sky Capital.

⁶ Source: US SIF Foundation and Cerulli Associates

⁷ Source: US SIF Foundation

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